No. 17354

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

CENTURY INDEMNITY COMPANY,

Appellant,

vs.

ROBERT A. RIDDELL, District Director of Internal Revenue for the Los Angeles District of California,

Appellee,

and

ROBERT A. RIDDELL, District Director of Internal Revenue for the Los Angeles District of California,

Appellant,

vs.

CENTURY INDEMNITY COMPANY,

Appellee.

On Appeals From the United States District Court for the Southern District of California.

BRIEF AND APPENDICES FOR THE DIRECTOR.

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TOPICAL INDEX

TABLE OF AUTHORITIES CITED

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BRIEF AND APPENDICES FOR THE DIRECTOR.

Opinion Below.

The opinion of the District Court (R. 327-328) is not officially reported.

Jurisdiction.

This action involves the liability of the taxpayer, Century Indemnity Company, for withholding taxes for the period between December 7, 1953, and September 17, 1954. On August 22, 1956, Robert A. Riddell, the District Director of Internal Revenue for the Los Angeles District of California (hereinafter referred to as the District Director), made assessments against taxpayer of *inter alia,* withholding taxes for the fourth quarter of 1953 and the first three quarters of 1954. On November 12, 1957, taxpayer, under protest, paid the assessed taxes and interest to the District Director. On January 7, 1958, the taxpayer filed a timely claim for refund of the amount assessed and paid, namely, $26,213.76. (R. 52-54.) No action having been taken on the claim for refund within six months, taxpayer filed a complaint, within the time provided in Section 3772 of the Internal Revenue Code of 1939, against the District Director in the United States District Court for the Southern District of California, Central Division, on October 7, 1958, praying for refund. (R. 3-35.) The answer of the District Director denying that the assessment and collection of the taxes from taxpayer was in any manner illegal was filed on December 8, 1958. (R. 35-44.) Jurisdiction was conferred on the District Court by 28 U.S.C., Section 1340. The findings of fact and conclusions of law were filed on December 5, 1960, and the judgment of the District Court was entered December 6, 1960. (R. 80-89.)

The judgment was in part for the Director and in part for the taxpayer. Notice of Appeal was filed by the taxpayer on February 2, 1961, and notice of cross-appeal was filed by the District Director on February 3, 1961. (R. 95-97.) Jurisdiction is conferred on this Court by 28 U.S.C., Section 1291.

Questions Presented.

The District Court held taxpayer was not liable to the District Director for payment of the federal income withholding taxes here involved relating to the period from December 7, 1953, to March 7, 1954, but held taxpayer was liable for payment of these taxes insofar as they related to the period from March 8, 1954, to September 17, 1954. The District Court determined that taxpayer had "control of the payment of the wages" and thus was liable during the latter period because for that time it authorized payment of wages from the trust account only by individual checks directly to the employees. Taxpayer was awarded judgment for refund of the withholding taxes which it had paid only with respect to the former period.[1]

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[1]The taxpayer was also awarded judgment for refund of the FICA and FUTA taxes which it had paid to the District Director and which it sought to recover in the court below. The District Court held that taxpayer was not the "employer" within the meaning of the statute for the purposes of these taxes. The holding of the District Court is not contested on appeal. The District Director's appeal with respect to the taxing of costs in the District Court is withdrawn.

The sole question presented by the taxpayer's appeal is whether the District Court erred in holding that taxpayer, during the period from March 8, 1954, to September 17, 1954, had "control of the payment of the wages" to individuals employed in connection with the performance of a subcontract let to White-Ahlgren Company, Inc., within the meaning of Section 1621(d) of the 1939 Code so as to be their "employer" within the terms of the statute and liable for withholding taxes on the wages paid to them during that time.

The sole question presented by the District Director's cross-appeal is whether the District Court erred in holding that taxpayer, during the period from December 7, 1953, to March 7, 1954, did not have "control of the payment of the wages" to individuals employed in connection with the performance of a subcontract let to White-Ahlgren Company, Inc., within the meaning of Section 1621(d) of the 1939 Code so as not to be their "employer" within the terms of the statute and thus not liable for withholding taxes on the wages paid to them during that time.

Statute and Regulations Involved.

The pertinent provisions of the Internal Revenue Code and the applicable Treasury Regulations are set forth in the Appendix, *infra*.

Statement.

The pertinent facts, as stipulated (R. 46-57) and as found by the District Court (R. 81-85), may be set forth as follows:

The taxpayer at all pertinent times was a Connecticut corporation qualified to do business in the State of California. (R. 81.)

On October 6, 1953, White-Ahlgren Company, Inc. (hereinafter referred to as White-Ahlgren) entered into a subcontract with Marine Development, Inc. (hereinafter Marine) whereby it undertook to complete the concrete work on a 1,000 unit Wherry Housing Project at Camp Pendleton, California. (R. 82.)

At the same time, White-Ahlgren made a written application to taxpayer for a contract bond and agreement of indemnity in the amount of its subcontract with Marine, namely, $549,138.20. (R. 47.)

Thereafter, on December 2, 1953, a surety bond described as Contract Bond No. 291379 in the amount of $549,138.20 was executed by and on behalf of White-Ahlgren as principal, the taxpayer as surety, Marine as owner, and Republic National Bank of Dallas, Texas as mortgagee. Under the bond, taxpayer guaranteed to Marine and the mortgagee the faithful performance of the subcontract and the payment of all labor and material incurred in connection with such performance. Work under the subcontract began on December 7, 1953. (R. 47, 82-83.)

At the time the bond was executed, White-Ahlgren opened a commercial checking account in the Security Trust and Savings Bank of San Diego, California which was designated "White-Ahlgren Trust Account No. 1" (hereinafter the trust account) and over which White-Ahlgren and taxpayer, as surety, had joint control. The resolutions and signature cards filed with the bank required all checks drawn against the trust account to be signed by an authorized representative of White-Ahlgren and to be countersigned by any one of several designated representatives of taxpayer. The latter was to sign as trustee. (R. 47-48, 83.)

Except for retention payments in the sum of $54,-249.18 paid directly by Marine to taxpayer on December 17, 1954, all progress payments made by Marine under the subcontract were required to be and were deposited directly into the trust account. The only job being performed by White-Ahlgren was the subcontract with Marine and at no time did White-Ahlgren receive any funds from any other job, contract or subcontract. (R. 83-85.)

Weekly payrolls for the employees of White-Ahlgren were made up by the latter's bookkeeper in the following manner: A time card for each employee was prepared by the foreman for White-Ahlgren and presented to the bookkeeper for computation. A recap of the total payroll was then prepared by the latter showing each employee's name, hours worked, rate of pay, gross amount due, total tax deductions, and net amount due, and a copy of the payroll recap was furnished to the representative of taxpayer before the net amounts were paid to the individual employees. (R. 49.)

For the period between December 7, 1953, and March 8, 1954, a weekly check payable to White-Ahlgren in the amount of the payroll was drawn on the trust account. The checks were signed by an authorized signatory of White-Ahlgren and countersigned by a duly authorized representative of taxpayer as trustee. For the period between December 7, 1953, and January 11, 1954, the check was drawn in the gross amount of each weekly payroll. Between January 12, 1954, and March 8, 1954, the check was drawn in the net amount of each weekly payroll, *i.e.,* the weekly gross amount of wages less federal withholding, Federal Insurance Contributions Act taxes and state taxes. The checks were deposited in the White-Ahlgren general account and checks to the individual employees were drawn from this account. (R. 84, 314.)

Commencing March 9, 1954, and ending with the completion of the subcontract on September 17, 1954, wage payments were made directly to the employees of White-Ahlgren from the trust account. The payments were made weekly by means of individual checks, drawn against the trust account, which were made payable to the order of each individual employee in the net amount due. Each of the checks was signed by an authorized signatory of White-Ahlgren and countersigned by a duly authorized representative of taxpayer as trustee. (R. 84-85.)

At no time pertinent herein did taxpayer have control over the employees of White-Ahlgren with reference to the hiring and discharge of employees, the work to be performed by the employees, the hours during which the employees were to perform their work, and the rate of pay to be received by the employees for their services. (R. 83-84.)

The District Court found as ultimate facts that the taxpayer did not have control of the payment of wages of the employees of White-Ahlgren for the period between December 7, 1953, and March 8, 1954, but that it did have control of the payment of their wages for the period between March 9, 1954, and September 17, 1954. (R. 84, 85.) Accordingly, the trial court concluded that the taxpayer was not the "employer" of the employees of White-Ahlgren for the period between December 7, 1953, and March 8, 1954, within the meaning of Sections 1621(d), 1622(a) and 1623 of the 1939 Code and that it was not liable for the payment of withholding taxes for that period. The court held, with respect to the period between March 9, 1954, and September 17, 1954, that the taxpayer was the "employer" of the employees of White-Ahlgren within the statute because of its control of the payment of wages and thus was liable for the payment of withholding taxes for that period. (R. 86-87.)

Statement of Points to Be Urged by Director on His Cross-Appeal.

1. The District Court erred in holding that taxpayer, during the period December 7, 1953, to March 8, 1954, did not have "control of the payment of the wages", within the meaning of Section 1621(d)(1) of the 1939 Internal Revenue Code, to employees engaged in a construction project subcontracted to White-Ahlgren Company, Inc.

2. The District Court erred in holding that the taxpayer was not, during the period December 7, 1953, to March 8, 1954, the "employer", within the meaning of Section 1621(d)(1) of the 1939 Internal Revenue Code,

of employees engaged in a construction project subcontracted to White-Ahlgren Company, Inc.

3. The District Court erred in failing to hold taxpayer, for the period December 7, 1953, to March 8, 1954, liable for income withholding taxes under Sections 1622 and 1623 of the 1939 Internal Revenue Code on the wages of employees engaged in a construction project subcontracted to White-Ahlgren Company, Inc.

Summary of Argument.

Provisions of the Internal Revenue Code applicable for the periods here involved require every "employer" making payment of wages to an individual to deduct and withhold from such wages a prescribed portion thereof, as an income withholding tax on wages, and to pay the withheld portion of such wages over to the District Director of Internal Revenue quarterly.

The sole question presented on this appeal is whether the taxpayer, was, from December 7, 1953, to September 17, 1954, the "employer", within the meaning of the statute, of the employees engaged in the construction project subcontracted to White-Ahlgren. More specifically, the question is whether taxpayer had "control of the payment of the wages" to these employees, as specified in Section 1621(d)(1) of the 1939 Code. If it did, then it is the "employer", as defined by the statute, and is, accordingly, liable for the federal income withholding taxes in question. We submit, on the plain facts of this case, that the taxpayer, at all pertinent times, had "control of the payment of the wages." Thus, we agree with the District Court insofar as it held that taxpayer had "control of the payment of the wages" in this case (namely, for the period from March

8, 1954, to September 17, 1954) but we believe the lower court erred in holding that taxpayer did not have "control of the payment of the wages" for the period from December 7, 1953, to March 7, 1954. The facts establish that the statutory control existed throughout all the time involved herein.

As the pertinent Treasury Regulations point out, the statutory language "control of the payment of the wages" means *legal* control of such payments. Thus, the important and controlling factor is whether the taxpayer has, in law, control of the funds or other means by which payment is made. The reason is plain. Clearly, only the person who legally controls the funds for payment of wages to employees is in a position to comply with the requirement of the Internal Revenue Code that specified amounts be withheld and collected from them for the benefit of the United States.

The facts of record show that the taxpayer, as a condition precedent to the issuance of the bond to White-Ahlgren, insisted upon and acquired legal title to and legal control of *all* funds earned under the subcontract between White-Ahlgren and Marine through a trust account arrangement. The taxpayer had absolute legal control of the funds for payment of wages and as a result, was the only person in a position to effect compliance with the requirement of withholding.

The facts of record further establish that the parties involved, including taxpayer's attorney, believed that the taxpayer was liable for the withholding taxes.

In actual fact, the taxpayer in this case was, through its legal control, using funds belonging to the United States Government to reduce its liability under the bond

on which it was surety for White-Ahlgren. By using these funds to pay materials bills and other pressing debts instead of holding them for the rightful owner, the Government, the taxpayer avoided expenditures otherwise necessary out of its own pocket. This is a far different situation than existed in the cases upon which taxpayer relies in its brief filed in this Court where there was nothing more than a mere supplying of money by a lender in the amount of the net payroll.

The decided cases holding that a trustee in bankruptcy, who makes payments in respect of wages earned by the bankrupt's employees before the bankruptcy is an employer for income withholding tax purposes within the meaning of Section 1621(d)(1) are most nearly in point here. The trustees in those cases, as the trustee representatives of the taxpayer in the instant case, succeeded as trustees to the legal custody and control of the funds out of which payment was made and thus, under the statute, are liable to withhold income taxes on wages paid out of the funds.

It is clear that the taxpayer in the instant case was in "control of the payment of the wages" within the meaning of Section 1621(d)(1) to employees engaged in a construction project subcontracted to White-Ahlgren throughout the entire period here involved—*i.e.,* from December 6, 1953, to September 17, 1954—and is liable for federal income withholding taxes on the wages paid.

ARGUMENT.

Taxpayer, During the Period From December 7, 1953, to September 17, 1954, Was the "Employer" Within the Terms of the Internal Revenue Code of Individuals Employed in Connection With a Subcontract Let to White-Ahlgren Company, Inc., and Thus Was Liable for Withholding Taxes on Wages Paid to Them During That Time.

A. Preliminary.

This appeal involves the liability of the taxpayer, the Century Indemnity Company, for federal income withholding taxes, along with a penalty and interest, for the fourth quarter of 1953 and the first three quarters of 1954. These taxes in the amount of $26,213.76 (including penalty and interest) (R. 54) were assessed against taxpayer in connection with wages paid on construction work performed by White-Ahlgren Company, Inc., under a subcontract let by Marine Development, Inc., for which the taxpayer acted as surety. The taxes were assessed under authority of Sections 1622(a) and 1623 of the 1939 Internal Revenue Code, Appendix A, *infra*.

Section 1622(a) requires every "employer" making payment of wages for the periods here involved to deduct and withhold upon such wages a tax equal to a specified percent of the amount by which the wages exceed the number of withholding exemptions, computed as therein provided. Section 1623 makes the "employer" liable for the payment of the tax required to be withheld under the subchapter dealing with the withholding tax.

The sole question presented on this appeal is whether the taxpayer was, from December 7, 1953, to September

17, 1954, the "employer", within the meaning of the statute, of the employees engaged in the construction project pursuant to the subcontract let to White-Ahlgren. More specifically, the question is whether taxpayer had "control of the payment of the wages" to these employees. If it did, then it is the "employer" as defined by the statute and it is, accordingly, liable for the aforementioned federal income withholding taxes.

Section 1621(d)(1) of the 1939 Code (Appendix A, *infra*) defines the term "employer" for purposes of the withholding tax, as follows:

> The term "employer" means the person for whom an individual performs or performed any service, of whatever nature, as the employee of such person, except that—
>
> (1) if the person for whom the individual performs or performed the services does not have control of the payment of the wages for such services, the term "employer" (except for the purposes of subsection (a)) means the person having control of the payment of such wages; * * *

Thus, the "employer"—the one who has the legal responsibility for withholding income taxes—is that person who has "control of the payment of the wages."

We submit, on the plain facts of this case, that the taxpayer, at all pertinent times, had "control of the payment of the wages" herein and that, accordingly, it is liable for withholding taxes on these wages as required by the Internal Revenue Code. Thus, we agree with the District Court insofar as it held that taxpayer had "control of the payment of the wages" in this case (namely, for the period from March 8, 1954, to

September 17, 1954) but we believe the lower court erred in holding that taxpayer did not have "control of the payment of the wages" for the period from December 7, 1953, to March 7, 1954. The facts establish that the statutory control existed throughout all the time involved herein.

B. Taxpayer, at All Pertinent Times, Had "Control of the Payment of the Wages."

It should be noted at the outset, as the pertinent Treasury Regulations (Treasury Regulations 120 (1939 Code), Section 406.205(c), Appendix A, *infra*) point out, that the statutory language "control of the payment of the wages" means *legal* control of such payments. Thus, the important and controlling factor in applying the statutory exception (Section 1621(d)(1)) is whether the taxpayer has, in law, control of the funds or other means by which payment is made. It is not significant for purposes of this exception who controls and performs the tasks of preparing the payroll sheets or making out the payroll checks.[2] See Rev. Rul. 57-22, 1957-1 Cum. Bull. 318; Rev. Rul. 54-471, 1954-2 Cum. Bull. 348. The important consideration is legal control of the funds for payment. The reason is plain. Clearly, only the person who legally controls the funds for payment of wages to employees is in a position to comply with the requirement of the Internal Revenue Code that specified amounts be withheld and collected from them for the benefit of the United States.

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[2]Nor, of course, is it pertinent in determining "legal" "control of the payment of the wages" who has control with reference to the hiring and discharge of employees, the hours during which the work is to be performed and the rate of pay to be received.

The facts of record in the instant case leave no doubt that it was the taxpayer who controlled the funds by which payment was made to employees working under the subcontract let to White-Ahlgren by Marine and that this control existed throughout the entire time the subcontract was being performed, namely, from December 7, 1953, to September 17, 1954—the period in question here. Only the taxpayer was in a position to comply with the requirement of withholding.

The evidence of record establishes that taxpayer required as a condition precedent to the issuance of the bond to White-Ahlgren (guranteeing the performance and payment of labor and material bills in the amount of 100% of the contract price) that a trust account be established in its behalf. The trust account was to be the depository for extra financing at the outset and for all monies earned under the subcontract when due. Demont J. Waite, the manager of taxpayer's bonding department in Los Angeles during all pertinent times, testified on cross-examination by the attorney for the District Director regarding this requirement as follows (R. 194-196):

> Q. Mr. Waite, to make sure that I understand you clearly, when they originally applied to you for a bond, you felt they were underfinanced and would not write the bond unless the extra cash was put up? A. That is right.
>
> Q. The original requirement with regard to extra cash was for them to put up $25,000 and Marine Development to advance $10,000? A. May I answer that other than yes or no?
>
> Q. Let me put it this way: Is that what you indicated in this letter [Defendant's Exhibit A, Appendix B, *infra*]? A. Yes.

Q. Now, as a matter of fact, however, you did eventually authorize the issuance of the bond when only a total of $25,000 was put up? A. That is right.

Q. Only $15,000 cash to the company and Marine Development's $10,000? A. Yes, sir.

The Court: And you began to sign the checks after the $25,000 had long previously been spent?

The Witness: I presume so.

The Court: So it was your intention here that the trustee account would not be limited primarily to the expenditure of the $35,000?

The Witness: Oh, no.

The Court: And it was your intention that all money expended by them on that job should go in a joint trust account?

The Witness: Yes, sir.

The Court: A joint account?

The Witness: Yes, sir.

Q. (By Mr. Sherman): Well, then, knowing that they were underfinanced and knowing that they had not even met your original requirements of deposit, didn't you, as the bonding manager for your company insist, as indicated in this letter, that the funds to be expended on the job be subject to the control in part of your company? A. No, sir. May I answer in my own words now to give you the story?

The Court: You can explain your answer if you desire.

The Witness: My original action was to turn the bond down, and when Mrs. Cole as agent came to me with other plans and financing thoughts that were to be included then I went ahead and said,

well, yes, maybe we can work it out on that basis.

Q. (By Mr. Sherman): Regardless of whose idea originally it was—whether Mrs. Cole's or yours—you did adopt this suggestion that you acquire a joint control before you would issue the bond. Is that correct? A. Yes, sir.

Q. As a matter of fact, is it not correct that you made known to the parties concerned that Century would require a joint control account before the bond was written? A. Yes, sir.

Q. And that is what was told to the Marine Development people. Is that correct? A. I presume so.

Q. Did you ever have any communication with the Marine Development Company people other than this letter? A. Well, that letter.

Q. Concerning what you would require? A. I may have, but I don't remember. I have met them. What was said at the time I do not remember.

Q. What would it be at variance with any thing you said in this letter? A. I am sure it would not be at variance, no, sir.

This requirement of taxpayer was consummated in the establishment of "White-Ahlgren Trust Account No. 1" at the Security Trust and Savings Bank of San Diego in December, 1953, at the time the bond was issued. (R. 82-83.) Of course, the purpose of the trust was to vest legal control of the funds earned under the subcontract in the taxpayer and this is exactly what was done.

The record shows that the instructions issued to the bank with regard to the trust account specifically so stated. The instructions, which were signed by repre-

sentatives of both taxpayer and White-Ahlgren, provided that *title* to the trust account and the funds therein was vested in trustees and attorneys in fact of the taxpayer to be held as security to the taxpayer. The precise language is as follows (Defendant's Exhibit "B", Appendix B, *infra*):

> The title to said account, and any balance that may be therein at any time is hereby vested and declared to be held by the aforesaid Trustee and Attorneys in Fact of the Century Indemnity Company, as security to the Century Indemnity Company that all funds to the credit of said account at any time shall be used solely for the purpose of paying bills for labor and material and all obligations entering into a certain construction project with reference to the completion of which said The Century Indemnity Company has executed an Indemnity Bond.

The trustee or attorneys in fact of the account were carefully chosen to represent the interests of the taxpayer. Thus, Eva Cole, who was appointed as the original trustee and also as an attorney in fact, was an insurance agent doing business with the taxpayer company. Mr. Waite, one of the original attorneys in fact, was the manager of the taxpayer's bonding department at all pertinent times. Burton A. Van Tassel, a subsequent trustee signatory, was a lawyer retained by the taxpayer company. (R. 47-48.) All testified that when acting as trustee or attorney in fact over the trust account that they were acting on behalf of the taxpayer. (R. 130, 196, 239.)

Throughout the life of the subcontract, all of the payments made by Marine under the subcontract—and at

no time did White-Ahlgren receive any funds from any other job, contract or subcontract—were deposited directly into the trust account. (R. 83, 85.) All bank statements were sent to the taxpayer who later sent them to White-Ahlgren. (R. 308.)

Thus, taxpayer, as a condition precedent to the issuance of a bond, acquired legal title to and legal control of all funds earned under the subcontract. The taxpayer had absolute legal control.

As a result of the trust account arrangement, only taxpayer was in a position to effect compliance with the requirements under the Internal Revenue Code of withholding income taxes from the wages of employees. It was the taxpayer, as seen, who, through its representatives, held legal title to *all* funds earned under the subcontract; these amounts were the only sums available to or earned by White-Ahlgren throughout the period here involved; and these funds were controlled by trustees who concededly were acting on behalf of the taxpayer. Clearly, taxpayer falls squarely within the definition of "employer" in Section 1621(d)(1) for purposes of the withholding tax. It was the sole "person" in a position to comply with the requirement of withholding taxes on the employees wages since it alone had legal control of the funds to be used for payment of the wages. As we have shown, this is the precise situation contemplated by the statutory exception.

The facts of record further establish that the parties involved in the arrangement between White-Ahlgren and taxpayer, including taxpayer's attorney, believed that the taxpayer was liable for the taxes here in question. Taxpayer's attorney, Mr. Van Tassel, testified on cross-

examination by the District Director's attorney as follows (R. 276-277):

The Court: When you say that that was the only reason why this wasn't paid [the payroll taxes], you mean by that to express that in your opinion those taxes were due and payable out of that account, the payroll account, and not otherwise payable by White-Ahlgren?

The Witness: Your Honor's question isn't clear to me.

The Court: You said the only reason this check was not paid was because there wasn't sufficient money in the payroll account, the trustee account.

The Witness: In the trustee account.

The Court: And by that statement, do you mean to give it as your opinion that that is the only account from which those taxes could have been collected, or could they have been collected from other assets and property of White-Ahlgren?

The Witness: They might have been collected in part at least, I would guess, from other assets of White-Ahlgren. I hadn't any knowledge as to that at that time. My knowledge of the situation was restricted to what the trustee account itself revealed as to a checkbook or a bank balance.

This was all in the early stages, if your Honor please, when I was getting my feet wet on the job.

The Court: I understand. *The implication of your answer is that the only reason it wasn't paid is that there wasn't any money and that that account owed the money, and if you had control of the account you owed the money, if that is what you mean to say.*

The Witness: *That is what I mean to say,* that there was insufficient money in that account with which to meet those payroll taxes at that time and I therefore declined to countersign a check.

The Court: And that is the only reason the tax was not paid?

The Witness: Yes.

The Court: It looks to me like that is about the end of your lawsuit, Counsel.

Mr. Burford: I don't think so, your Honor.

The Court: I mean, if that is the only reason the tax wasn't paid then the tax was due out of that account. [Emphasis supplied.]

Indeed, the parties hardly could have reached a conclusion other than that the taxpayer assumed liability for the payroll taxes. With the brief exception of the period between December 7, 1953, and January 11, 1954, trustees for the taxpayer allowed payment out of the trust account for wages only of amounts sufficient to meet the *net* amount of the weekly payroll, *i.e.* the gross amount of wages less federal withholding, Federal Insurance Contributions Act taxes and state taxes. (R. 84-85.) Thus amounts attributable to payroll taxes remained in the trustee account under the legal title and control of taxpayer's representatives and were never available to White-Ahlgren for payment to the Government. The fact White-Ahlgren did not have control of the funds for payment to the Government is well illustrated by one occasion when White-Ahlgren's bookkeeper presented checks for federal and state payroll taxes to taxpayer's attorney Mr. Van Tassel (who was a trustee of the account) for his signature. Mr. Van Tassel refused to sign the checks for the amounts drawn or for any lesser amounts and, accordingly, the

taxes were not paid. Mrs. Higgins, White-Ahlgren's bookkeeper testified on direct-examination by the District Director's attorney as follows (R. 308-309):

Q. Now, Mrs. Higgins, directing your attention to on or about April 30, 1954, did you have occasion to discuss the payment of Federal withholding and employment taxes with Mr. Van Tassel? A. Yes, sir.

Q. Would you please tell us what took place at that time? A. On this date, April 30th, I presented to Mr. Van Tassel a check for both the Federal and the State payroll taxes for his signature.

Q. By "payroll taxes with reference to the Federal taxes," do you mean the withholding and the employment taxes? A. I do.

Q. All right; please continue. A. I presented this check or, rather, two checks, one to the State and one to the Federal government, for his signature along with the reports.

Q. You mean the returns? A. The returns, yes.

Mr. Van Tassel told me at that time to mail in the returns but that we would be in a better position later on to sign these checks.

Q. Did he at that time sign any checks? A. The checks were not signed.

Q. Did he at that time indicate that if a check in a lesser amount were presented to him he would sign it? A. No, sir.

Q. Did he say anything further to you at that time? A. Not at that time.

Q. What did you then do? A. I mailed the returns.

Q. Without payment? A. Without payment.

Q. Did Mr. Van Tassel ever approve a check for payment thereafter? A. A check was never canceled it was never signed. Mr. White of White-Ahlgren testified that he at no time promised Mr. Van Tassel or any member of taxpayer that White-Ahlgren would pay the federal taxes. (R. 229.)

In actual fact, the taxpayer in this case was, through its legal control, using funds belonging to the United States Government to reduce its liability under the bond on which it was surety for White-Ahlgren. By using these funds to pay materials bills and other pressing debts instead of holding them for the rightful owner, the Government, the taxpayer avoided expenditures otherwise necessary out of its own pocket. This is a far different situation than existed in *Westover v. William Simpson Const. Co.,* 209 F. 2d 908 (C. A. 9th), and *Fireman's Fund Indemnity Co. v. United States,* 210 F. 2d 472 (C. A. 9th), upon which the taxpayer places particular reliance in its brief filed in this Court. In each of these cases, there was a mere loan or advance of sufficient monies to meet the net or "take-home" wages. None of the lenders were ever in a position to meet the withholding requirements of the Internal Revenue Code since none of them ever controlled funds which would have enabled them to do so.

Thus, in the *Simpson* case, when a subcontractor became financially embarrassed, the principal contractor

agreed to transfer sufficient funds to meet "take-home" pay. Actually the funds advanced had already been earned by the subcontractor and payment was simply accelerated. This Court said (p. 911):

> The legislative history of §1621(d) makes it clear that something more than the mere supplying of the money for the payroll is essential.* * *

In the *Fireman's Fund* case, which this Court decided on the basis of *Simpson*, the factual situation was substantially the same. There, the surety for a contractor advanced funds to the contractor (when it no longer had funds sufficient to carry on its work) which enabled it to meet net or "take-home" salaries of its employees. Paragraph XI of the stipulation of facts in that case provided as follows:

> That only the net, or take-home pay, that is, the gross wages less the required deductions Federal unemployment taxes, Federal Insurance Contributions taxes and withholding taxes and other deductions, was at all times paid to the employees of Swedlow Engineering Co., Inc., during the periods in this stipulation mentioned.

This Court held, in effect, that the surety was simply a lender of the net amounts advanced, the same as the contractor in *Simpson,* and had no control over the payment of wages and certainly not over sums owing to the Government for witholding taxes. In like manner, *Phinney v. Southern Warehouse Corp.,* 212 F. 2d 488 (C. A. 5th).

In the instance case, on the contrary, as noted, the taxpayer had control of *all* the funds received from Marine under the subcontract and was not merely advancing sufficient sums to meet net payrolls.

With respect to *Reliance Insurance Co. v. United States* (N. D. Calif.), decided November 27, 1959 (60-1 U. S. T. C., par. 9315) also cited by taxpayer, since the opinion of the Court does not set forth a sufficient statement of facts, we can only assume in view of the Court's reliance on *Simpson* and *Southern Warehouse* that the facts there were similar to the facts in the cases relied upon. As shown, these cases have no application to the case at bar.

The decided cases most in point are *United States v. Fogarty,* 164 F. 2d 26 (C. A. 8th), *United States v. Curtis,* 198 F. 2d 268 (C. A. 6th), and *In re Daigle,* 111 Fed. Supp. 109 (S. D. Me.). These cases hold that a trustee in bankruptcy who makes payments in respect of wages earned by the bankrupt's employee before the bankruptcy is an employer for income withholding tax purposes. The trustees in those cases, as the trustee representatives of the taxpayer in the instant case, succeeded as trustees to the legal custody and control of the funds out of which payment was made and thus, under the statute, became liable to withhold income taxes on the wages paid out of the funds. The Court in *Fogarty* said (p. 32):

> Although much of what has been said concerning the liability of the trustee for the employ-

> ment taxes is applicable to the question of his liability for these taxes, the last quoted statutory provisions appear on their face to apply directly to the situation here where the company which employed the wage earners has gone into bankruptcy and lost control over the payment of the wages and its trustee succeeded to the custody and control of its assets and actually made the payment out of such assets. * * * We think, * * * that the trustee was the one in control of the payment of wages within the intent of Section 1621(d). The purpose is to treat the actual payor of the remuneration as the employer for withholding and payment purposes.

For the reasons stated, it is clear that the taxpayer in the instant case was in "control of the payment of the wages" within the meaning of Section 1621(d)(1) of the 1939 Code to employees engaged in a construction project subcontracted to White-Ahlgren throughout the entire period involved—*i.e.,* from December 7, 1953, to September 17, 1954—and thus is liable for federal income withholding taxes on the wages paid.

Conclusion.

The District Court erred insofar as it held that taxpayer was not in "control of the payment of the wages", namely, for the period December 7, 1953, to March 7, 1954, and to this extent should be reversed. The District Court was correct insofar as it held that taxpayer was in "control of the payment of the wages",

namely, for the period March 8, 1954, to September 17, 1954, and to this extent should be affirmed.

Respectfully submitted,

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February, 1962.

APPENDIX A.

Internal Revenue Code of 1939:

SEC. 1621 [As added by Sec. 2(a) of the Current Tax Payment Act of 1943, c. 120, 57 Stat. 126]. DEFINITIONS.

As used in this subchapter—

* * *

(d) *Employer.*—The term "employer" means the person for whom an individual performs or performed any service, of whatever nature, as the employee of such person, except that—

(1) if the person for whom the individual performs or performed the services does not have control of the payment of the wages for such services, the term "employer" (except for the purposes of subsection (a)) means the person having control of the payment of such wages; and

(a) in the case of a person paying wages on behalf of a nonresident alien individual, foreign partnership, or foreign corporation, not engaged in trade or business within the United States, the term "employer" (except for the purposes of subsection (a)) means such person.

(26 U. S. C. 1952 ed., Sec. 1621.)

SEC. 1622 [As added by Sec. 2(a) of the Current Tax Payment Act of 1943, *supra,* and amended by Sec. 501 of the Revenue Act of 1948, c. 168, 62 Stat. 110, Sec. 141 of the Revenue Act of 1950, c. 994, 64 Stat. 906, and Sec. 201 of the Revenue Act of 1951, c. 521, 65 Stat. 452]. INCOME TAX COLLECTED AT SOURCE.

(a) *Requirement of Withholding.*—Every employer making payment of wages shall deduct and withhold upon such wages a tax equal to 18 per centum of the amount by which the wages exceed the number of withholding exemptions claimed multiplied by the amount of one such exemption as shown in subsection (b)(1), except that in the case of wages paid on or after November 1, 1951, and before January 1, 1954, the tax shall be equal to 20 per centum of such excess in lieu of 18 per centum.

* * *

(26 U. S. C. 1952 ed., Sec. 1622.)

SEC. 1623 [As added by Sec. 2(a) of the Current Tax Payment Act of 1943, *supra*]. LIABILITY FOR TAX.

The employer shall be liable for the payment of the tax required to be deducted and withheld under this subchapter, and shall not be liable to any person for the amount of any such payment.

(26 U. S. C. 1952 ed., Sec. 1623.)

Treasury Regulations 120 (1939 Code):

SEC. 406.205. *Employer.*—

(a) The term "employer" means any person for whom an individual performs or performed any service, of whatever nature, as the employee of such person.

(b) It is not necessary that the services be continuing at the time the wages are paid in order that the status of employer exist. Thus, for purposes of withholding, a person for whom an individual has performed past services for which he

is still receiving wages from such person is an "employer."

(c) If the person for whom the services are or were performed does not have legal control of the payment of the wages for such services, the term "employer" means (except for the purpose of the definition of "wages") the person having such control. For example, where wages, such as certain types of pensions or retired pay, are paid by a trust and the person for whom the services were performed has no legal control over the payment of such wages, the trust is the "employer."

(d) The term "employer" also means (except for the purpose of the definition of "wages") any person paying wages on behalf of a nonresident alien individual, foreign partnership, or foreign corporation, not engaged in trade or business within the United States (including Puerto Rico as if a part of the United States).

(e) It is a basic purpose to centralize in the employer the responsibility for withholding, returning, and paying the tax and furnishing the statements required under section 1633. The foregoing two special definitions of the term "employer" are designed solely to meet unusual situations. They are not intended as a departure from the basic purpose.

(f) An employer may be an individual, a corporation, a partnership, a trust, an estate, a joint-stock company, an association, or a syndicate, group, pool, joint venture, or other unincorporated organization, group, or entity. A trust or estate, rather than the fiduciary acting for or on behalf of the trust or estate, is generally the employer.

(g) The term "employer" embraces not only individuals and organizations engaged in trade or business, but organizations exempt from income tax, such as religious and charitable organizations, educational institutions, clubs, social organizations and societies, as well as the governments of the United States, the States, Territories, Puerto Rico, and the District of Columbia, including their agencies, instrumentalities, and political subdivisions.

Treasury Regulations 120 apply only to the year 1954. Section 405.105 of Treasury Regulations 116 (1939 Code) which is applicable to the fourth quarter of 1953, also here involved, is in all essential respects the same as Section 406.205 of Treasury Regulations 120.

APPENDIX B.

Defendant's Exhibit A.

November 16, 1953

Marine Development, Inc.
302 Robinson Building
San Diego 1, California

Re: White-Ahlgren Company, Inc. Subcontract for all concrete work.

Gentlemen:

White-Ahlgren Company, Inc. and your Company are now considering the execution of a contract for the construction of the concrete work as named above for the Title VIII Wherry Housing Project, Camp Pendleton, California, for the aggregate contract price of $549,138.20.

White-Ahlgren Company, Inc. are not now sufficiently financed to permit us as surety to execute a bond for 100% of the job. It is anticipated that additional financing is to be invested in that corporation which, when received, will permit us to execute such a 100% bond.

We as surety do commit ourselves to a firm agreement that upon receipt of $25,000.00 in cash by White-Ahlgren Company, Inc., which is anticipated to be put into the corporation on or before November 25, 1953 and an advance payment of $10,000.00 by Marine Development, Inc. to White-Ahlgren Company, Inc. which specific sum of money is to be deposited in a special

bank account of White-Ahlgren Company, Inc., of which we as surety will have joint control, we agree that when said conditions have been met that we will issue to you a bond guaranteeing the performance and payment of labor and material bills in the amount of 100% of the contract price.

Very truly yours,

THE CENTURY INDEMNITY COMPANY

By D. J. Waite

Attorney In Fact

DJW:hg

Defendant's Exhibit B.

December 2, 1953

INSTRUCTIONS TO: SECURITY TRUST & SAVINGS BANK OF SAN DIEGO.

Name of bank

RE: WHITE-AHLGREN TRUST ACCOUNT NO. 1.

From time to time you will receive checks for credit to the above account which you will deposit to the credit of said account. You will permit withdrawals from said account only upon checks signed by White-Ahlgren Company, Inc. (Contractor) and countersigned by Eva L. Cole, Trustee, or upon checks signed by either D. J. Waite or Eva L. Cole or Frank D. Cole as Attorney-in Fact of the Century Indemnity Company.

The title to said account, and any balance that may be therein at any time is hereby vested and declared to be held by the aforesaid Trustee and Attorneys in Fact of the Century Indemnity Company, as security to the Century Indemnity Company that all funds to the credit of said account at any time shall be used solely for the purpose of paying bills for labor and material and all obligations entering into a certain construction project with reference to the completion of which said The Century Indemnity Company has executed an Indemnity Bond.

Notwithstanding anything hereinbefore contained to the contrary, SECURITY TRUST & SAVINGS BANK OF SAN DIEGO is authorized to pay any

Name of bank

checks, drafts, or orders when signed as hereinabove provided, without inquiry in any case as to circum-

stances of their issue or the disposition of their proceeds, whether drawn to the individual order of, or tendered in payment of individual obligations of the persons above named or otherwise.

These instructions are being sent in triplicate, and your acknowledgment of their receipt on the two copies and their return to the Century Indemnity Company will be appreciated.

Attested by:

Irene Higgins

WHITE-AHLGREN COMPANY, INC.

By W. T. Ahlgren

W. T. Ahlgren, President (Contractor)

Eva L. Cole

Eva L. Cole (Trustee)

THE SECURITY INDEMNITY COMPANY

By D. J. Waite

D. J. Waite - Attorney-in-Fact

By Eva L. Cole

Eva L. Cole - Attorney-in-Fact

By Frank D. Cole

Frank D. Cole - Attorney-in-Fact

ABOVE ATTESTED TO:

SECURITY TRUST & SAVINGS BANK OF SAN DIEGO

M.E. FRAZIER 1/12/54

By H. P.

Title